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CONCERNING MODERN CORPORATE MORTGAGES

by - Henry S. Drinker, Jr.

As each new lawyer is called on to struggle seriously with the modern form of corporate mortgage, he experiences a series of mental reactions which are a practical duplication of those through which, during the last fifteen years, each of his predecessors has passed.

Following close on the initial bewilderment at the very bulk of the thing (often 150 pages without the description) comes a feeling of protest at its complication and the thought that if only he had the time and opportunity, he could cut down the text to ten pages, or to fifteen at the outside.

Let us suppose, then, that to a young lawyer of our acquaintance, comes this opportunity. An important client calls on him to prepare a corporate mortgage with all the appurtenances--additional bonds issuable in series without limit as to principal amount, fully registered as well as coupon bonds, additional bonds for additions and improvements, the acquisition of stocks and bonds of subsidiaries, refunding of underlying liens and prior series, conversion privileges, sinking funds, possible modifications of the indenture, maintenance of assets, and all the other modern developments.

He is given a month and expects to finish in a week.

From a banker friend he borrows three or four standard mortgages and merrily begins with his scissors and his red pencil.

For a time all goes well. Before long, however, as he studies the different clauses and begins to understand their purpose and legal effect, it gradually dawns on him that there is more solid meat in all this legal verbiage than he had supposed. He realizes that the provision which yesterday he so lightly deleted may well be of importance to his client in a contingency which until now had not occurred to him.

Again and again this happens, until in despair he tires of rubbing out, and resolves to begin over again, raising his space limit to fifty pages (or seventy-five at the outside) and his time limit to two weeks.

Determined to make a complete job of it, he borrows three or four more forms from another friend and begins to compare the clauses in the different forms. To his surprise he finds that the form which he had been following and which had seemed to him so unnecessarily complete, really lacked certain provisions which might well be most useful. These he adds to his draft--a step fatal to his initial resolution.

He has by this time reached the definition stage, when he is assured that by proper definitions in Article I he can cut the text in half and make all the obscure provisions perfectly clear. He constructs, with great labor and ingenuity, a mass of arbitrary definitions, such as "refundable divisional lien bonds," "isolated properties," primary purposes of the Company's business," and "cost of an acquired system," which finally aggregates ten or twelve pages. These phrases are then used in italics throughout the succeeding

articles, and are perfectly clear to the author of them, but entirely unintelligible to anyone else without continued reference to the Definition Article, which entails so much cross reference and consequent interruption of thought as to make the result even more difficult to understand than before.

Now he turns to the decisions and studies the law of reorganizations and the administration of corporate trusts. As he does so, he begins to realize how little the average lawyer knows of the practical problems and difficulties which the provisions of a corporate mortgage are designed to solve and to guard against. He also begins to understand why the modern mortgage has grown to its present size and complication.

Beginning with the simple ten-page document of thirty years ago, each new set of lawyers which has attacked the problem (for there are usually three lawyers in every case, representing bankers, mortgagor and trustee) has added provisions to meet the specific points which their individual experience and imagination suggest, each being fearful to omit anything lest he have overlooked some Court decision which renders the omitted clause essential for his client's interest. Many mortgages, too, are prepared in the first instance with scissors and paste, by juniors, who, anxious to make a hit with the firm, cull out clauses to meet every remotest contingency. Their seniors, seeing no objection, lacking time to investigate (and with perhaps a feeling that their client will not expect the fee to vary inversely with the size of the production) do not attempt to cut down. Those who have the time have not the necessary experience; those who have the experience have not the time.

But to return to our hero.

His month is almost up, but his new mortgage is still far from complete. What he has produced is nothing like that which he started out to make. Instead of ten pages it is eighty. Instead of omitting most of the provisions of the long form he has added additional clauses. While many changes and abbreviations still seem feasible, to risk those requires more experience and more study of the decided cases.

It is at this stage that there usually appears another client with another and urgent piece of business which makes it impossible for our lawyer longer to give his time exclusively to this pioneer work. Fearful of assuming the responsibility of omitting anything without more study and experience, and realizing that to do what he started out to accomplish will require him to give up all his other practice for an indefinite period, he goes back to the standard form, lock, stock and barrel, with the additions culled from many sources, resulting in a considerable net increase in size.

After all is said, most of the sympathy expressed for those compelled to read corporate mortgages is wasted, for the reason that, with one notable exception, no one ever reads a corporate mortgage except those who are both familiar with all its difficulties and well compensated for their trouble.

As illustrating what has been said, the writer has prepared a special provision which may be added at the end of any corporate mortgage. It is believed that the elucidation which the thorough comprehension of this clause entails, will render the preceding provisions of the average corporate mortgage, by contrast, relatively simple and clear.

ARTICLE XXIII.

This Indenture, with any supplemental instruments which, in its discretion the Trustee (or its successor or successors in the trust herein provided) may require the more fully to effectuate the same, as well as each and every the Bonds now or hereafter issued and to be issued hereunder and secured hereby or intended to be, together with the coupons, if any, thereto at any time annexed or appertaining, shall be interpreted according to the interpretation which would have been applicable thereto if this Article XXIII hereof regulating and prescribing the interpretation thereof respectively were not and/or had

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never been contained herein, anything herein or in said Bonds and coupons to be contrary notwithstanding; provided, however, and it is hereby expressly agreed between the Company and the Trustee, between the Trustee and the Company, and by each of them with each and every the holder or holders of the said Bonds and coupons, if any, now or hereafter at any time issued and outstanding hereunder, and the said holders of said Bonds and coupons, if any, by accepting the same respectively, do hereby covenant for themselves, their respective heirs, executors, administrators, successors and assigns that nothing herein or in said Bonds and coupons contained, shall be so construed or applied, as in any way or manner, or at any time or times, or under any circumstances and/or conditions whatsoever, to hinder, prevent, delay, restrain, or infinitesimally to deter any counsel, solicitor and/or attorney, learned in the law or otherwise, of any court of record of law or in equity, in any jurisdiction, from in any lawful manner insisting or maintaining that the true and proper interpretation hereof differs, either in whole or in part, or otherwise whatsoever, from that hereinabove specified or intended so to be; but anything herein or in said Bonds or coupons to the contrary notwithstanding, any such attorney may, and on the written request of the holders of a majority in face amount of the Bonds secured hereby then outstanding on the happening of any of the events of default hereinabove specified or at any time prior or subsequent thereto shall, but at the cost, charge and expense of the Company, dispose of, dissipate and utterly consume, in whole or in such parcels as to them may at the time seem meet and/or be considered most advantageous to them, their heirs, executors, administrators and assigns, the time (which is hereby declared to be the essence of the contract), the money (of the present standard of weight and/or fineness and/or otherwise) and the patience (which is hereby declared to be the essence of the Trustee, but without responsibility for the application of the proceeds, unless satisfactorily indemnified) of each and every the parties hereto; it being expressly understood that this Indenture, as well as the said Bonds and the coupons, if any, thereto appertaining, unless called for previous redemption, together with any, all and every the interchangeably incomprehensible provisions herein contained are intended primarily for the benefit of each and every the said attorneys, their heirs, executors, administrators and assigns, without preference or priority of any over the others, or of the others over any, equally and ratably, with the same force and effect as if each and every the said attorneys had intermeddled with the same without cessation or interruption, either by the Trustee or by the holders of twenty-five per centum (25%) in face amount of the Bonds secured hereby then outstanding, continuously from a year and a day next preceding the date hereof, whichever be greater, and for their and each of their so doing these presents shall be and remain full authority and security, otherwise to be void and of no effect.

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RECENT CASES

Actions - Standing of Public Utilities Without Exclusive Franchises to Enjoin Competition by Municipality.

Public Utility operating within municipality but not having exclusive franchise sought to enjoin city officials from entering a contract with the Public Works Administration for a loan of money to build a competing plant. The Utility alleged that since the plans, specifications, rates to be charged, etc., were subject to the final approval of the Administrator of the Public Works Administration who could withhold portions of the loan upon non-compliance by the municipality with his instructions, the City, by entering such a contract was improperly delegating its functions to the Public Works Administration. Held, the Public Utility, lacking an exclusive franchise, has no standing to contest the actions of the city since it has no right to be free of competition. Southwestern Gas & Electric Co. v. City of Texarkana, 109 F. (2d) 847 (C.C.A. 5th, 1939).

Corporations - Failure to File Certificate of Paid-In-Cash Does Not Confer Individual Contract Liability Upon Incorporators.

Kansas statute requires that certificate setting forth that not less than 20% of corporation's authorized capital stock had been paid for must be filed as part of incorporation procedure. Corporation failed to file the certificate and subsequently entered into a lease arrangement with plaintiff. Plaintiff now seeks to hold incorporators to individual liability under the contract. Held, judgment for the defendants. Kraemer v. Graf, 105 F. (2d) 117 C.C.A. 10th, 1939).

The court stated that although the affidavit had not yet been filed, yet the defect in corporate organization was not so serious as to enable any of the parties to a contract with the corporation to vitiate the contract. The state through the attorney-general may, of course, institute a quo warranto action, but that does not mean that the corporation has no power to enter into contracts.

Negligence - Rejection of Workmen's Compensation Act - Liability of Electric Company to Lineman for Negligence.

Lineman employed by Electric Company was engaged in stretching wires between the Company's poles. At the time of injury, he was working on a pole which had been so improperly constructed as to leave a ground wire exposed. The lineman's duty was to signal a man on the ground when the wires between the poles had reached the proper tautness. In so doing, his fingers touched the high tension wires; one of his feet was at that moment in contact with the exposed ground wire. This closed the circuit and caused his death. The evidence indicated that the lineman himself had been negligent since he failed to use rubber gloves and perhaps should have chosen a different pole upon which to work. The electric company had rejected the state workmen's compensation act. The jury gave a verdict of $10,000 to lineman's widow. Held, affirmed. Tampa Electric Co. v. Hardy, 190 So. 478 (Fla. 1939).

Contributory negligence of the lineman did not excuse the company from liability, since the state workmen's compensation act was meant to provide compensation in such cases. Rejection of the Act by the Company did not lessen the liability of the company. The verdict of $10,000 was not excessive.

Statute of Limitations - Non-Application to Federal Government.

United States Government had deposits in bank which was liquidated under state law. The Government failed to file a claim within the period presented by the Missouri statutes. Held, claim of the Government is not barred. United States v. Holt, 131 S.W. (2d) 59 (Mo. Ct. App., 1939).

State laws cannot so impair the sovereignty of the United States as to bar a claim of the Government under a state statute of limitations.

ADMINISTRATIVE INTERPRETATIONS

The Federal Power Commission ruled that an electric utility, the actual lines of which are entirely within a single state, is subject to the jurisdiction of the Federal Power Commission if its lines constitute part of a pathway to which electrical energy is transmitted across state lines. This would appear to be in accordance with the constitutional doctrines of interstate commerce but is a new precedent insofar as the rulings of the Power Commission are concerned. Federal Power Act Release, No. 940, July 20, 1939.

STATUTES

Wisconsin

Amends Cooperative Act to Alter Quorum Requirements and Vote Necessary to Amend Articles of Incorporation.

In place of the requirement that 20% of the total membership be present in person or proxy for a quorum, there is now set up the following scale: 20% if the Cooperative has 200 members, 15% for membership of 200-500, 10% for membership of 500 to 1000, and 10% of the first thousand members and 5% of the number in excess of one thousand. A provision that a number not less than twice the number of directors may constitute a quorum and transact all business specifically stated in the notice of the meeting at any regular or special meeting, has been retained. It has not yet been determined whether this provision applies only to Cooperatives having a membership in excess of a thousand or to all Cooperatives.

The articles of incorporation may now be amended by vote of three-fourths of a quorum; formerly, the vote of a majority of the total membership was required.

LEGAL MEMORANDA RECEIVED IN AUGUST

A-37 Validity of Railroad Crossing Agreements Giving Preferential Treatment to Cooperative.

A-38 Validity of Rate Difference for Cooperative Service to Members and Non-Members in Tennessee.

A-39 Procedure for Simultaneous Recordation of Deed and Counterparts in Relation to Federal Documentary Stamp Tax.

A-40 Use of Windshield Stickers on Automobiles - A Survey of State Statutes.

A-41 Study of Tax and Judgment Liens in Tennessee.

A-43 Need for Careful Legal Check of Communications Between Cooperatives and Their Members in re Statements Warning Against Use of Particular Electrical Appliances.

A-46 Liability of Cooperative for Failure of Electric Service to Railroads Operating Signal Device.

A-47 Duties and Responsibilities of Persons Countersigning Checks.

A-49 Right of President of Cooperative to Vote at Directors' meeting.

A-52 Propriety of Attachment of Identification Tags to Automobiles by Project Officials.

A-55 Non-liability of Cooperatives for Payment of Interest on Consumers Deposits.

A-56 Necessity of Filing of Chattel Mortgages in Arkansas.